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INSIGHT

The End of Intra-EU Investor-State Dispute Settlement (ISDS): Implications for the United States

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On January 15, 2019, the 28 European Union (EU) member states declared that they will terminate all intra-European bilateral investment treaties (BITs) (i.e., those between member states) no later than December 6, 2019 (see the Declaration). The action by the EU member states is the latest in a series of actions that has altered the status of traditional investor-state-dispute settlement (ISDS) mechanisms within the European Union. ISDS mechanisms, which enable foreign investors to bring disputes with host states before independent international arbitral tribunals, have been a common feature in BITs and other trade and investment agreements throughout the world. These changes may have implications for U.S. approaches to investment in the European Union.

ISDS Background

For decades, ISDS has been the preferred means for capital exporting countries to protect the interests of their nationals as they invested abroad and to enforce the terms of investment agreements. Likewise, ISDS was a favored means used by capital importing countries to encourage investment. Many U.S. international trade and investment agreements as well as the 1984, 2004, and 2012 Model Bilateral Investment Treaties have included investor-state dispute settlement mechanisms for resolving disputes between foreign investors and their host states.

In recent years, however, ISDS has become a subject of increasing debate among some stakeholders in the United States and the European Union. Last year, while some Senators described ISDS as "an essential enforcement mechanism for investor protections [that] must be maintained" in any renegotiation of the North American Free Trade Agreement (NAFTA), other Senators called for the elimination of ISDS in any new agreement. In the European Union, critics of ISDS have been particularly vocal. While the now-inactive U.S.-EU negotiations on the Transatlantic Trade and Investment Partnership (T-TIP) were ongoing, large protests broke out across Europe, partially in response to the treaty's ISDS provisions. Following the protests, EU Trade Commissioner Cecilia Malmström observed that, among the public, ISDS seemed to have become "the most toxic acronym in Europe." (See Video)

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Uncertain Future of ISDS Mechanisms in the European Union

In March 2018, the European Court of Justice (ECJ), the highest court of the European Union, held in *Slovak Republic v. Achmea BV* that the governing treaty of the European Union precluded ISDS provisions in agreements concluded between member states. The court reasoned that because ISDS arbitral tribunals might apply or interpret EU law, such provisions had "an adverse effect on the autonomy of EU law" since international arbitral tribunals might interpret or apply EU law.

In response to the ECJ's findings, EU member states declared, among other things, their intention to terminate all bilateral investment treaties concluded between EU member states. The member states also declared that they will request that courts, including those in non-EU countries, set aside any awards issued in an intra-EU investment arbitration. Most of the member states also declared that the decision meant that intra-EU ISDS claims under multilateral agreements were also invalid (although six member states disagreed with that conclusion in two separate declarations (see Declaration 1 and Declaration 2)).

While these declarations only concern ISDS provisions in intra-EU BITs, the *Achmea* judgment has caused some uncertainty about whether ISDS provisions in extra-EU BITs are compatible with EU law. Some scholars argue that the ECJ could extend *Achmea's* reasoning to invalidate ISDS provisions in agreements between EU and non-EU member states, such as the United States. Other scholars, however, are skeptical of such claims. While the ECJ could not invalidate such BITs itself, current EU regulations require that member states "eliminate incompatibilities, where they exist, with Union law, contained in bilateral investment agreements concluded between them and third countries." The United States has nine BITs with EU member states that contain ISDS provisions **(Figure 1)**. As of July 2018, three disputes between U.S. investors and EU member states (Poland and Estonia) are currently pending before tribunals constituted pursuant to those BITs.

Figure 1. U.S.-European Union Member Bilateral Investment Treaties

Source: U.S. Department of State.

In 2015, following consultation with EU stakeholders, the European Commission proposed establishing a permanent multilateral investment court, dubbed the Investment Court System (ICS) to replace ISDS provisions. The European Union has included the ICS in its recent trade agreements with Canada, Mexico, Singapore, and Vietnam. However, the ECJ's reasoning in *Achmea* has some scholars and member states wondering if the ICS is compatible with the EU treaties.

The *Achmea* decision, the development of the ICS, and these recent EU Member State declarations terminating intra-EU BITs are examples of the trend in the EU away from the use of traditional ISDS for the resolution of investment disputes. The EU Commission succinctly summarized the likely outcome of this trend when it wrote, "For the EU[,] ISDS is dead."

Issues for Congress

The European Union is the United States' largest destination for foreign direct investment. In 2017, Americans invested $3.2 trillion in the European Union. On October 16, 2018, U.S. Trade Representative (USTR) Robert Lighthizer notified Congress that the Administration intended to start negotiations with the European Union to reduce transatlantic barriers to trade. While the scope of the negotiations is uncertain, they could include subjects related to investment. Current trade promotion authority includes, as a principal negotiating objective, protecting investors by "providing meaningful procedures for resolving investment disputes." Furthermore, the USTR's specific U.S.-EU negotiating objectives include securing for U.S. investors "important rights consistent with U.S. legal principles." The United States had traditionally met such objectives through the inclusion of ISDS provisions, although the limitations on ISDS in the recently proposed United States-Mexico-Canada Agreement (USMCA) indicates that the current Administration's approach to ISDS is evolving.

These recent policies and decisions have left the future of ISDS in the European Union uncertain. While the European Union is a proponent of a multilateral ICS, its compatibility with the EU treaties is currently unsettled. Given these issues, Congress may consider alternative approaches for securing the rights of U.S. investors in the bloc, including through potential new trade agreement talks.

Looking ahead, the ECJ is expected to rule on the compatibility of the ICS with EU treaties. That decision will likely have repercussions for the future of investment dispute mechanisms in the European Union.

Author Information

Christopher A. Casey
Analyst in International Trade and Finance

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